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RELEASED

Review Of Grants To
Health Maintenance Organization
Of South Carolina, Inc. B-164031(2)

Department of Health, Education,
and Welfare

9/1/74

090144

**BY THE COMPTROLLER GENERAL
OF THE UNITED STATES**

MAY 17, 1974



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON DC 20548

B-164031(2)

C The Honorable Ernest F Hollings
United States Senate

R Dear Senator Hollings

-2 This is our report on review of grants made to the Health Maintenance Organization of South Carolina, Inc., by the Department of Health, Education, and Welfare in response to your December 14, 1973, request 22
D 1499

As requested, we have not obtained written comments from the Department or the grantee. We did, however, discuss our findings with Department and grantee officials and their comments are recognized in the report.

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On January 17, 1974, we were requested by Senator Strom Thurmond to perform an audit of this organization. Therefore, we are providing a similar report to Senator Thurmond As agreed with your office, we are also providing a copy of this report to Congressman Mendel Davis and to the Secretary of Health, Education, and Welfare.

We do not plan to distribute this report further

Sincerely yours,

Acting Comptroller General
of the United States

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ABBREVIATIONS

GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
HMO	health maintenance organization
HMOSC	Health Maintenance Organization of South Carolina Inc
MSIA	Management Systems, Inc of America
MSISC	Management Systems, Inc of South Carolina
SGTR	Standardized Government Travel Regulations

D I G E S T

WHY THE REVIEW WAS MADE

By letter dated December 14, 1973, Senator Ernest F Hollings requested that GAO investigate the operations of the Health Maintenance Organization of South Carolina, Inc (HMOSC). HMOSC has received grants totaling about \$477,000 from the Department of Health, Education, and Welfare (HEW) to study the feasibility of and to develop a health maintenance organization, which, when operational, would provide health services to the residents of Berkeley, Charleston, and Dorchester Counties in South Carolina.

The HEW grants were provided for the period November 1, 1971 through December 31, 1974. GAO reviewed the receipts, disbursements, and administrative practices of HMOSC under the grants. GAO also reviewed programmatic aspects of HMOSC's operations to the extent necessary to determine the organization's status in relation to the purposes for which the HEW grants were made. GAO did not, however, attempt to fully evaluate HMOSC's accomplishments. GAO's work at the HMOSC location in Charleston, South Carolina, was completed on April 23, 1974.

As requested by Senator Hollings, neither HMOSC nor HEW were given an opportunity to review and formally comment on this report. Meetings were held, however, in which the

HMOSC and HEW officials were given an opportunity to informally comment on the GAO findings. Their comments, to the extent they were offered, have been considered in the preparation of this report. At a meeting held at the completion of the fieldwork HMOSC officials declined to comment on the GAO's findings, however, most of GAO's audit information had been previously discussed with HMOSC officials and their comments were given consideration.

FINDINGS AND CONCLUSIONS

Accounting system and
internal controls

HMOSC's accounting system and related internal controls were not based on generally accepted principles and were not adequate to ensure compliance with HEW requirements to properly account for the expenditure of Federal funds.

HMOSC accounting records consisted essentially of checkbooks and cancelled checks until around February 1974 when cash receipts and disbursements journals were prepared. The journals did not include a record of transactions in all of HMOSC's checking and savings accounts. The accounting system did not provide for the recording of advances, receivables and payables. No inventory records of supplies and equipment were maintained. (See p 5.)

Compensation of officers
and employees

Although the amounts provided in the approved grants for the personal services of the three HMOSC officers are not clearly determinable, information furnished GAO by an HMOSC employee indicates that for the period November 1, 1971, through December 31, 1973, payments to them exceeded by a total of about \$57,000 the amounts provided for in the approved budgets (See p 13.) GAO also found that

- Large amounts were paid to the corporate officers before such amounts could have been earned under the terms of the HEW grants. This practice resulted in depletion of grant funds long before completion of grant periods and necessitated repeated borrowing to pay expenses.
- Payments to corporate officers, supposedly made on a fee-for-service basis, were not based on adequate records. Some payments were recorded as loans and advances. No payments made to corporate officers were reported to Internal Revenue Service.
- Grant funds were used for personal purposes of corporate officers and for payment of expenses of a company in which the corporate officers had a financial interest (See p. 13)

Contrary to grant regulations, three HMOSC employees received supplements to their regular salaries totaling about \$7,400 (See p 26) Three employees were paid about \$18,300 in 1972 and 1973 which was not reported to the Internal Revenue Service (See p 27)

Travel expenses

Deficiencies in expenditures for travel included

- \$10,246 spent in excess of the approved budget for travel during the period November 1, 1971, through December 31, 1973, without the required HEW approval
- Travel vouchers were generally not submitted
- Excessive advances were not accounted for or refunded
- Travel expenses of HMOSC officers' families were paid with grant funds
- First class air travel was used on 37 of the 40 trips on which documentation was available
- A travel allowance was paid without regard to extent of travel actually performed (See p 28)

Other matter

Another practice for which the required HEW approval was not obtained involved the use of grant continuation funds to pay expenses incurred prior to the beginning date of the continuation award (See p 11)

Allowability of expenditures

Because of the number of categories for which the allowability of expenditures is being questioned and the duplication of amounts included in some of the categories, GAO did not attempt to precisely establish the total amount of unallowable payments. However, the amount for which the allowability is questionable under

the terms of the HEW grants approximates \$100,000

Status of project

The primary objective of the Federal grants to HMOSC has been to develop an operational health maintenance organization for the Charleston, South Carolina area. Although the expected date for achieving that goal has been changed a number of times, the most recent grant award provided for HMOSC to become operational by July 1, 1974. In GAO's opinion, the prospects of HMOSC's becoming operational on any scale by that date or as presently constituted, ever operating on the scale envisioned in the grants, are remote (See p 35)

HEW management

HEW did not perform a pre-award survey of HMOSC's accounting system and administrative procedures to determine their adequacy and although HEW regional office personnel visited the grantee on a number of occasions, GAO found no indication that the HEW representatives ever examined the financial records of HMOSC or involved themselves in matters of grant administration in more than a superficial way. HEW did not enforce the requirement for submission of expenditure reports (See p 6)

After GAO discussed its tentative findings with HEW officials, HEW informed HMOSC on March 15, 1974, that additional payments under the current grant would not be made and requested that HMOSC furnish

--an expenditure report for the cur-

rent grant for the period January 1974 through March 15, 1974

--an explanation of the adjustment to be made for use of 1974 grant funds to pay 1973 expenses

--expenditure reports for the previous grants by March 22, 1974, and

--a detail plan for payment of outstanding obligations and an expenditure plan for the remainder of the budget period

At the time HEW stopped future grant payments to HMOSC, \$140,000 of the authorized \$180,000 under the current grant for calendar year 1974 had been received by HMOSC, including a \$10,000 overpayment from the previous grant period (See p 7)

GAO believes that before grants are awarded there should be some assurance that prospective grantees have adequate accounting systems with appropriate internal controls to protect the interests of the Federal Government. This could be done through an examination by the HEW Audit Agency or by requiring prospective grantees to obtain a certification of the adequacy of their accounting system and internal controls from an independent public accountant. GAO also believes that grants should be audited periodically to ensure that grantees' accounting and internal control systems are operating effectively, adequate records are being maintained, and grant funds are being adequately controlled and expended only for grant purposes in accordance with Federal grant policies. HEW has been formally advised of the GAO conclusions on these aspects of grant administration

CHAPTER 1

INTRODUCTION

In response to requests from Senator Ernest F Hollings and Senator Strom Thurmond, in letters dated December 14, 1973, and January 17, 1974, respectively, this report is concerned with the financial and administrative practices of the Health Maintenance Organization of South Carolina, Inc (HMOSC) under grants from the Department of Health, Education, and Welfare (HEW).

HMOSC was organized in Charleston, South Carolina, on August 4, 1971, and incorporated as a non-profit corporation on August 20, 1971, to develop and eventually operate a health maintenance organization (HMO) HMOSC proposed to develop a comprehensive health benefits package which would include physician and dentist services, hospital care, laboratory and X-ray services, medicines and drugs, and health education, and to offer this package to residents of Berkeley, Charleston, and Dorchester Counties--either as individuals or as members of groups--for a pre-determined, pre-paid premium. In conjunction with the benefits package, HMOSC proposed to establish and operate a communications system which would assure enrollees of communication with health care providers at all times and to establish and operate a transportation system to assure enrollees of transportation to receive care under either routine or emergency conditions

HMOSC enrollees would be free to select their own physicians, dentists, and other providers, who would be paid by HMOSC for services rendered at rates previously agreed upon As part of its agreement with health care providers, HMOSC would operate an extensive computer system which would largely relieve providers of the burdens of patient accounting and billing, and at the same time assure providers of prompt payment

For the period November 1, 1971, through December 31, 1974, HMOSC received four HEW grants totaling \$477,216 for a study of the feasibility of an HMO in the Charleston area and for a planning and development effort designed to lead to establishment of an operational HMO At the time of the most recent grant award, December 1973, it was expected that HMOSC would achieve operational status on July 1, 1974, but that a reduced level of planning and developmental effort would be

required through December 31, 1974. No Federal funds have been provided for operation of an HMO

Through March 31, 1974, actual HEW grant payments to HMOSC totaled \$437,216

Administration of the grants to HMOSC is a responsibility of HEW's Health Services Administration, Bureau of Community Health Services HEW's Region IV, Atlanta, Georgia, reviewed and recommended approval by HEW headquarters of HMOSC grant applications. Region IV was responsible for monitoring the grantee's activities.

Audit responsibility for grants such as the ones awarded to HMOSC is with HEW's Audit Agency

SCOPE OF REVIEW

We reviewed the receipts, disbursements, and administrative practices of HMOSC under the HEW grants. We also reviewed aspects of HMOSC's operations to the extent necessary to determine the organization's status in relation to the purposes for which the HEW grants were made We did not, however, attempt to fully evaluate the organization's accomplishments Our work at the HMOSC location in Charleston, South Carolina, was completed on April 23, 1974

As requested by Senator Hollings, in the interest of more timely reporting, neither HMOSC nor HEW have had an opportunity to formally review and comment on our findings. At the conclusion of our work at HMOSC a meeting was held in Charleston, South Carolina, with HMOSC and HEW officials to apprise them of the matters to be discussed in this report and to solicit their comments on those matters HMOSC officials declined to comment orally on our findings, but insisted upon a written statement of findings to which they would respond in writing We did, however, during the course of the review, discuss our audit information with HMOSC officials and their comments were considered in preparing the report and are included where appropriate

CHAPTER 2

PROJECT MANAGEMENT

Management responsibility for HMOSC is vested by its by-laws in a board of directors, and in the offices of president, vice president, treasurer, and secretary. The by-laws also provide for an advisory council but do not specify what its function should be. Management control of HMOSC was maintained by the three incorporators who named themselves as directors and officers of the corporation.

HMOSC's accounting system and related internal controls were not adequate to ensure compliance with HEW requirements to properly account for the expenditure of Federal funds. HEW project management has been limited essentially to program considerations, with little or no attention to financial or administrative matters.

BOARD OF DIRECTORS AND OFFICERS

The board of directors, which the by-laws limits to not more than five members, is given general authority to manage the affairs of the corporation, including the appointment and removal of officers. Directors are not permitted a salary for their services as such, but are specifically permitted to serve the corporation in other capacities and to be paid for such services.

At the first organizational meeting on August 4, 1971, the three incorporators constituted themselves as the directors of HMOSC. The directors appointed themselves to the officer positions established in the by-laws. One was appointed president, one was appointed to fill the positions of vice president and treasurer, and one was appointed secretary.

HEW's Guidelines for the Submission, Review and Award of HMO Planning and Operational Grants stated that one of the major priorities to be considered in the award of planning grants was a demonstration of the involvement of consumers in planning, organizing, and operating the HMO. HMOSC records contain several references to informal urgings by HEW regional office personnel that the board be expanded to broaden the base of community involvement in the project,

but they never aggressively pursued the point. HEW records related to review of grant applications contain observations that the board was not representative of the community and that it should be expanded, but HEW did not formally request expansion nor make it a condition of grant approval

The by-laws have not been amended to increase the size of the board of directors, but since May 1973, when the member who served as vice-president/treasurer resigned, the board has been expanded, and--although it is not now clear who all the members have been at any particular time--now includes a number of persons who had not previously been directly connected with the project. The president of HMOSC gave us the names of 16 persons whom he said either had served or are serving as directors of HMOSC. We contacted 15 of these persons and were told by all but one that they either are or were members of HMOSC's board of directors.

The status of the office of treasurer since the above mentioned resignation is not clear. One person, who was listed as a director and as treasurer in the latter part of 1973, told us that she had been invited to serve on the board but had declined the invitation. On November 27, 1973, another person--a member of the expanded board--submitted his resignation from the position of director and treasurer. The president told us that it was not intended that this person would serve as treasurer until HMOSC achieved operational status. The office of treasurer was vacant as of April 23, 1974.

On April 15, 1974, the member of the original board who served as secretary resigned. The records do not show when, but a new secretary has been appointed.

HMOSC records contain minutes of only three board meetings--the first meeting in August 1971 and two meetings of the expanded board in January 1974. The president of HMOSC told us that many board meetings were held for which formal minutes were not prepared. The two meetings held in January 1974 were devoted essentially to orienting the new members to the concepts and purposes of HMOSC without the conduct of corporate business. Our discussions with past and present members of the expanded board indicated that most meetings which they attended were of this nature and that their contribution to HMOSC policy and management were minimal.

ADVISORY COUNCIL

The by-laws provide that the advisory council shall be "elected by the Directors from outstanding business and professional persons in the community " At the first board of directors meeting, the president was instructed to seek out the names of prospective council members "keeping in mind that the Advisory Council shall be composed of a cross-section of the community." Persons selected to serve have included housewives, a retired farmer, a barber, a salesman, a public accountant, an attorney, a school teacher, and a minister

There have been only two meetings of the advisory council--one in September 1972 and one in November 1972. The first meeting was attended by eight members, the second by six We were able to contact four members who had attended either one or both meetings Their comments indicate that, although the members were given an opportunity to ask questions and to express opinions, the meetings were largely informational.

ACCOUNTING SYSTEM AND RELATED INTERNAL CONTROLS

HEW's policy statement for administration of grants awarded under section 314(e) of the Public Health Service Act (42 U S.C. 246e) which is applicable to all HEW grants to HMOSC, states that grant funds will be accounted for in accordance with the grantee's accounting practices, based upon generally accepted principles, consistently applied, and in sufficient detail to disclose the exact nature of all expenditures. HMOSC's accounting system and internal controls are not based upon generally accepted principles and are not adequate to ensure compliance with HEW requirements to properly account for the expenditure of Federal funds

HMOSC accounting records consist essentially of check-books, canceled checks, and cash receipts and disbursements journals. The cash receipts and disbursement journals were not prepared until around February 1974, and did not include a record of transactions in all of HMOSC's checking and savings accounts The accounting system did not provide for the recording of advances, receivables and payables.

No inventory records of supplies and equipment were maintained

Other deficiencies in the accounting system and internal controls included the following

- Records showing the nature of many expenditures were not available For example, for 139 disbursements totaling \$11,154 for travel expenses there was no information available as to who traveled, where, how, or for what purpose
- A separate bank account was established for payroll expenditures but was used for payment of travel, telephone and rent expenses and for repayment of loans.
- Time, attendance, and leave records were not maintained for corporate officers or employees
- Personnel actions and rates of pay were not documented
- One person kept payroll records, signed payroll checks, and distributed payroll checks.

At December 31, 1973, unrecorded accounts and notes payable totaled \$62,633, of which \$10,783 had been outstanding since August 1973

An inventory of office furniture and equipment which we made in March 1974, showed that four tape recorder/players (\$578), one cocktail table (\$72), and one desk and chair (\$395) could not be accounted for We were told by an HMOSC employee that the president had the tape recorder/players, and that the desk and chair had been delivered to a former HMOSC board member. On March 6, 1974, the former director refunded the price of the desk and chair plus \$21 interest

HEW MANAGEMENT

On a number of occasions during the period of the grants, personnel of the HEW regional office visited HMOSC, and HMOSC officials visited the HEW regional office Documentation of matters discussed or agreements reached during these meetings is quite limited and there is no indication that HEW representatives ever examined the financial records of

HMOSC or involved themselves in matters of grant administration in more than a superficial way. HEW did not make a pre-award survey to determine the adequacy of HMOSC's accounting system and has not audited the activities of HMOSC

HEW requires grantees to submit expenditure reports, by budget line item, 60 days after completion of a budget period. HMOSC should have submitted an expenditure report on the initial grant of \$25,000 by December 30, 1972, and on three other grants by March 1, 1974. These reports were not submitted, and HEW did not aggressively attempt to obtain them.

After we discussed our tentative findings with HEW officials, HEW informed HMOSC on March 15, 1974, that additional payments under the current grant would not be made and requested that HMOSC furnish

- an expenditure report for the current grant for the period January 1974 through March 15, 1974.
- an explanation of the adjustment to be made for use of 1974 grant funds to pay 1973 expenses (see p 11).
- expenditure reports for the previous grants by March 22, 1974, and
- a detail plan for payment of outstanding obligations and an expenditures plan for the remainder of the budget period.

At the time HEW stopped future grant payments to HMOSC, \$140,000 of the authorized \$180,000 under the current grant for calendar year 1974 had been received by HMOSC, including a \$10,000 overpayment from the previous grant period. The overpayment is explained on page 9. We believe that before grants are awarded there should be some assurance that prospective grantees have adequate accounting systems with appropriate internal controls to protect the interests of the Federal Government. This could be done through an examination by the HEW Audit Agency or by requiring prospective grantees to obtain a certification of the adequacy of their accounting systems and internal controls from an

independent public accountant We also believe that grants should be audited periodically to ensure that (1) grantees' accounting and internal control systems are operating effectively, (2) adequate records are being maintained, and (3) grant funds are being adequately controlled, and expended only for grant purposes in accordance with Federal grant policies We have formally advised HEW of our conclusions of these aspects of grant administration

CHAPTER 3

FUNDING

HMOSC has received from HEW four grants totaling \$477,216 for the period November 1, 1971, through December 31, 1974. The grants have not clearly established the extent to which non-Federal support of the project would be provided but deposits by the three officers accounted for only 11 percent of the total cash receipts for the period November 1, 1971 through December 31, 1973. There have been no cash contributions from other sources and no record of in-kind contributions from any source.

FEDERAL GRANTS

The following schedule summarizes the HEW grants to HMOSC

<u>Date of grant award</u>	<u>Budget period</u>		<u>Amount</u>
	<u>From</u>	<u>To</u>	
Jan 18, 1972	11-1-71	10-31-72	\$ 25,000
June 14, 1972	7-1-72	12-31-73	112,440
Feb 1, 1973	1-1-73	12-31-73	109,776
June 18, 1973 ^a	1-1-73	12-31-73	50,000
Dec 20, 1973	1-1-74	12-31-74	<u>180,000</u>
			<u>\$477,216</u>

^aAmends and extends grant award dated 2-1-73

The \$112,440 grant awarded June 14, 1972, was made under Title IX of the Public Health Service Act (42 U.S.C. 299). All the others were made under section 314(e) of the Public Health Service Act (42 U.S.C. 246(e)).

Payments under the grants through December 31, 1973, totaled \$307,216, which was \$10,000 more than the total of the grants awarded through that date. The excess payment resulted from delay in HMOSC's receipt of a \$10,000 check issued by HEW on September 18, 1973, and HEW's issuance of a replacement check on September 28, 1973. HEW is aware of the overpayment, and has told us that the amount available under the 1974 grant has been reduced accordingly.

NON-FEDERAL CONTRIBUTION

HEW's policy statement provides that, while there is no specific matching percentage required for health services development project grants, a grantee must assume part of the project costs. It provides for the amount of the grantee's support to be shown in the application for Federal funds and in the notice of grant award. The notices of grant award show that HMOSC's contribution to the estimated cost of the project would be as follows:

<u>Budget period</u>	<u>Contributions</u>
11-1-71 - 10-31-72	20 percent
7-1-72 - 12-31-73	None
1-1-73 - 12-31-73	18.8 percent
7-1-73 - 12-31-73	15 percent

The grant agreements did not specify the extent to which the contributions were to be cash or in-kind. We asked HEW regional office officials to establish the amount of the non-Federal contribution expected of HMOSC. Their response was that inasmuch as the Public Health Service Act does not prescribe any specific or minimum contribution for these types of grants, the requirement is met if a grantee provides any part of the cost of carrying out a project.

Through December 31, 1973, HMOSC's total cash receipts were \$340,593.95. Of this amount, \$3,789.95 (1.1 percent), was deposited by the three officers. The remainder of \$338,188.32 (98.9 percent) came from HEW and from a bank loan which was repaid with grant funds in February 1974. Not included in this amount is \$75,000 in bank loans which were repaid with grant funds before December 31, 1973.

BANK LOANS

On four occasions, HMOSC borrowed funds from a bank in Charleston as shown by the following schedule:

<u>Date of note</u>	<u>Amount</u>	<u>Interest rate</u>
July 6, 1972	\$50,000	7%
Dec 4, 1972	5,000	8%
Jan 30, 1973	20,000	8%
Dec 21, 1973	30,000	8%

All four loans were repaid with grant funds These loans are discussed further in Chapter 4

USE OF GRANT FUNDS TO
PAY EXPENSES OF PREVIOUS
GRANT PERIODS

HEW's policy statement provides that a grantee may, at his own risk, incur expenses in excess of the amounts provided in the grants for a period, and that HEW will allow payment of those expenses from a continuation grant, provided the items to be covered are incorporated in the approved budget for the continuation grant HMOSC did not include in its application for grant funds for calendar year 1974 any provision for using funds awarded pursuant to that application to pay expenses of the previous grant period, but has used 1974 grant funds to pay expenses incurred before January 1, 1974

At November 30, 1973, the balances in HMOSC's bank accounts totaled \$207 99 On December 21, 1973, a bank loan of \$30,000 was obtained and the proceeds of \$29,588 were deposited in the grant account At December 31, 1973, the balances in HMOSC's bank accounts totaled \$5,266 39

In addition to the \$30,000 note payable to the bank, at December 31, 1973, HMOSC had accounts payable of about \$32,600 to suppliers and consultants for goods and services provided before December 31, 1973--\$10,783 of which had been outstanding since August 1973

Through March 31, 1974, HMOSC had received \$130,000 in 1974 grant funds Of this amount, \$30,000 was used to repay the bank loan and \$4,830 was used to pay part of the accounts payable at December 31, 1973 An expenditure plan which HMOSC submitted to HEW on April 12, 1974, providing for expenditures for the remainder of 1974, listed as still outstanding \$27,859 in "outstanding bills prior to January "

HEW officials told us that they were not aware that HMOSC would use 1974 grant funds to pay expenses incurred in the prior grant period and that they had not approved such action.

The allowability of the use of 1974 grant funds to pay expenses incurred in excess of approved budgets of prior grant periods is discussed on page 50.

CHAPTER 4

PAYMENTS TO OR FOR THE BENEFIT OF

CORPORATE OFFICERS

The amounts provided in the approved grants for personal services of the three corporate officers are not clearly determinable. However, information furnished to us by an HMOSC employee indicates that for the period November 1, 1971 through December 31, 1973, payments to them exceeded by a total of about \$57,000 the amounts provided for them in approved budgets. Most of the amounts paid to them large sums paid before such amounts could have been earned under the terms of the HEW grants, resulting in depletion of grant funds long before completion of grant periods and necessitating repeated borrowing to pay expenses. They supposedly were paid on a fee-for-services basis but accurate records of hours worked were not kept. The amounts paid to them were arbitrarily determined, seemingly related more to the availability of funds than to effort on HMOSC affairs.

Grant funds paid to them were run through other bank accounts and were shown in the records as loans and advances. According to a corporate officer, this was done in an attempt to avoid payment of income taxes. Grant funds were used for personal purposes of corporate officers and for payment of expenses of a company in which corporate officers had a financial interest. Also, HMOSC did business with firms in which corporate officers had an interest without demonstrating that doing business with these firms was in the best interest of the project.

GRANT FUNDS PAID TO CORPORATE OFFICERS EXCEEDED AMOUNTS PROVIDED FOR THEM

The amounts provided in the approved grants for personal services of the three corporate officers are not clearly determinable because the budget periods overlap (see p 9), more than one position title and salary rate is applicable to the same individual for the same period of time, and the percentage of time to be devoted to project activities is not consistent under different grants for the same individuals for the same periods of time.

At the first board of directors meeting on August 27, 1971, the president was directed to enter into an agreement to retain himself as Medical Director on a fee-for-services basis of \$50 an hour plus travel, transportation, and any other appropriate expenses, to enter into an agreement with the vice president/treasurer to retain him as counsel for the corporation on a fee-for-services basis of \$50 an hour plus travel, transportation, and any other appropriate expenses, and to enter into an agreement with the secretary to retain him as Director of Systems, Communications, and Personnel on a fee-for-services basis of \$35 an hour plus travel, transportation, and any other appropriate expenses. Because the individuals are referred to by various titles in various grant related documents, the three corporate officers are identified in this and subsequent sections of the report as the Medical Director, Counsel, and the Executive Director.

The provisions of the approved budgets applicable to compensation of the corporate officers for the period November 1, 1971 through December 31, 1973, are shown in the following schedule

<u>Budget period</u>	<u>Position</u>	<u>Percentage of time to be spent on project</u>	<u>Federal funds provided for position</u>
11-1-71 to 10-31-72	Project Director	75%-12 mos	\$ 9,600
	Administrator	100%-12 mos	2,880
7-1-72 to 12-31-73	Project Director	90%-12 mos	28,800
	Assistant Director	100%-12 mos	20,800
	Administrative Ass't for Systems Development	100%- 9 mos	8,475
1-1-73 to 6-30-73	Project Director	100%- 6 mos	3,000
	Assistant Director	100%- 6 mos	3,000
	Project Manager	100%- 6 mos	11,000
1-1-73 to 12-31-73 (amends and extends previous grant)	Project Director	90%- 6 mos	12,150
	Executive Director	90%- 6 mos	11,390

An HMOSC employee, who at the time of our review was engaged in attempting to prepare a revised budget for the entire period November 1, 1971 through December 31, 1973, identified for us the persons who were intended to fill the budgeted positions with the following results

<u>Budget period</u>	<u>Position</u>	<u>Medical Director</u>	<u>Counsel</u>	<u>Executive Director</u>
11-1-71 to 10-31-72	Project Director Administrator	\$ 9,600		\$ 2,880
7-1-72 to 12-31-73	Project Director Asst Director Adm Ass't for Systems Development	28,800	\$20,800	8,475
1-1-73 to 6-30-73	Project Director Asst Director Project Manager	3,000	3,000	11,000
1-1-73 to 12-31-73	Project Director Executive Director	12,150		<u>11,390</u>
Total amount budgeted		<u>\$53,550</u>	<u>\$23,800</u>	<u>\$33,745</u>

The amounts paid to the corporate officers exceeded the amounts provided for them in the approved budgets by the following amounts

	<u>Medical Director</u>	<u>Counsel</u>	<u>Executive Director</u>	<u>Total</u>
Budgeted	\$53,550	\$23,800	\$33,745	\$111,095
Paid	76,451	40,169	51,477	168,097
Excess payment	22,901	16,369	17,732	57,002

None of the payments shown for the Counsel and not all those shown for the other two officers were recorded in HMOSC's records as payments for personal services. Most of those to the Counsel were recorded as payment for legal services. The make-up of the amounts and the allowability of amounts in excess of the approved budgets are discussed later in this chapter and on page 42.

UNCONTROLLED PAYMENTS TO CORPORATE OFFICERS CAUSED PERSISTENT SHORTAGE OF FUNDS AND NECESSITATED BORROWING TO PAY EXPENSES

The first payment under the HEW grants was for \$15,000 received by HMOSC on January 24, 1972. On that date, \$13,550 was paid to the three corporate officers. The second payment of \$10,000 was received on February 7, 1972, and on that date \$9,450 was paid to the three corporate officers. Thus by February 7, 1972, \$23,000 of the \$25,000 grant for the period

November 1, 1971 through October 31, 1972, had been paid to the corporate officers--as compared to \$14,880 provided in the grant for them for the entire period. This pattern of the corporate officers withdrawing large sums in advance, leaving relatively little for other purposes specified in the grants, was followed rather consistently through December 31, 1972, and necessitated repeated borrowing to pay expenses.

On June 14, 1972, HEW notified HMOSC of the award of a continuation grant in the amount of \$112,440 for the budget period July 1, 1972 through December 31, 1973. At that time, payments to corporate officers had consumed 93 percent of grant funds received and the bank balance was \$91.20.

On July 6, 1972, HMOSC negotiated a bank loan of \$50,000 (proceeds \$49,980), assigning as security therefor its receipts under the approved continuation grant. On that same date, \$40,000 was withdrawn from the loan account and paid to the three corporate officers. During the month of July, other withdrawals from the loan proceeds by the corporate officers totaled \$8,622. On July 31, 1972, \$59,910 in grant funds were received and on that date payments totaling \$16,800 were made to two of the corporate officers. The \$50,000 bank loan was repaid with grant funds--one payment of \$30,000 in August 1972 and two payments of \$10,000 each, in October and December 1972.

On December 4, 1972, a second loan of \$5,000 (proceeds \$4,897) was negotiated and on that date \$4,929 was paid to the corporate officers. See page 20 concerning the manner in which this loan was obtained and repaid with grant funds.

At December 31, 1972, grant payments totaled \$119,840 of which \$105,646 (88 percent) had been paid to the corporate officers. The bank balance at December 31, was \$1,683, indicating that only about \$12,500 had been spent for other purposes.

The total amount budgeted for the officers through December 31, 1972--all of the amounts budgeted for the period November 1, 1971 through October 31, 1972, and one-third of the amount budgeted for the period July 1, 1972 through December 31, 1973, (see p.15)--totaled \$31,838 or \$73,808 less than the amount paid to them.

During 1973, the percentage of grant funds paid to corporate officers declined to 43 percent (the treasurer resigned on May 21, 1973, and received no payments during the year). However, two additional bank loans totaling \$50,000 were obtained during the year--a \$20,000 loan in January and a \$30,000 loan in December. Before the latter loan was obtained the bank balance had declined to \$208 and HMOSC could not pay salaries of employees (see p 26) Although budget overruns in areas other than personal services of corporate officers were a factor in HMOSC's unfavorable cash position, the \$20,000 and \$30,000 loans would not have been necessary if payments to the officers in 1972 had been in line with budgeted amounts.

For the period November 1, 1971 through December 31, 1973, amounts budgeted for the corporate officers equaled 37 percent of the total amount of the grants. The amount paid to them equaled about 57 percent of the grants for the period

PAYMENTS TO CORPORATE OFFICERS
FOR PERSONAL SERVICES NOT BASED
ON ADEQUATE RECORDS

As previously stated, payment of grant funds to the three corporate officers exceeded by about \$57,000 the amounts included in approved grant budgets for them and the officers were supposedly being paid an hourly rate on a fee-for-services basis.

The initial grant shows that the Medical Director was to be paid at a rate of \$50 an hour but shows all other personal services costs on the basis of annual salaries. The other grants show a salary basis for all personal services costs, including the Medical Director.

Payment for personal services on an hourly basis presupposes an accurate record of the hours worked but HMOSC did not keep such records. About one week before our review began in February 1974, HMOSC prepared summaries purporting to show time spent on HMOSC activities by the Medical Director and the Executive Director from January 1, 1972, through December 31, 1973. The Executive Director said these summaries were based on scratch notes and calendars, but these were not available for our review. An HMOSC secretary who typed the summaries said they were really guesses as to the time spent on HMOSC activity.

Comparison of the summaries with the Medical Director's diary showed that they included time when he was on vacation and time when he was regularly scheduled to be at the site of one of his two medical practices. On the occasion of a 6-day trip which the Medical Director made to California and Washington, D.C., the summaries included 6 days at 24 hours a day.

The summaries of total time, if priced out at \$50 and \$35 an hour would support more than the amounts paid to the Medical Director and the Executive Director, but in our opinion they are not adequate to support the payments made

At the time of his resignation from HMOSC, the Counsel submitted summaries of time spent on HMOSC activities. He told us that these summaries were usually prepared as soon as practicable after performance of the service, and the summaries

appear to have been prepared in this way. They show the date and hours during which service was performed and the nature of the activity performed. However, when priced out at \$50 an hour, plus listed expenses, they support payment of \$39,649, compared to payments of \$40,169 made to him. The Counsel said that he had not submitted time summaries for all of his HMOSC activities and that his total service to HMOSC would justify a greater amount than he received. However, he could not furnish us with additional records which would support this contention.

One of the Counsel's summaries concerns a discussion which he had with an official of the HEW regional office on the subject of payment of the corporate officers on a fee-for-services basis. The HEW official is quoted as having said that HMOSC should submit an amended budget requesting a change from a salary to a fee-for-services basis and that such a request probably would be approved. In our opinion, HEW should not permit payment on a fee-for-services basis to persons who are supposed to work full-time, or substantially full-time, on project activities. The hourly rate of \$50 for the Medical Director and the Counsel might be reasonable for specialists whose services are obtained on an intermittent, consultative basis and whose hourly rates must cover all expenses related to their performance of a service, but could be considered as being unreasonably high for the day-to-day management of a project such as the HMOSC. Defining "full-time" as 40 hours a week, an hourly rate of \$50 equals an annual salary of \$104,000 and an hourly rate of \$35 equals an annual salary of \$72,800.

To illustrate, the Counsel's summaries include the following services billed to HMOSC at \$50 an hour

- reproducing 100 copies of the revised budget--2 hours
\$100,
- discussions concerning secretarial supervision and
setting up in-out baskets-2 hours, \$100,
- preparing and reviewing grant application--31 hours,
\$1,550, and
- preparing job description--15 hours, \$750.

The Counsel's records show that on one occasion he and the other two corporate officers went to Columbia for a 2-hour meeting with a State official. He showed 2 hours driving time each way and charged the project 6 hours at \$50 an hour.

At the conclusion of our work, we discussed with regional HEW officials the subject of payments on a fee-for-services basis to persons who are supposed to work full time or substantially full time on project activities. These officials said that notwithstanding the provision in the first grant for payment of the Medical Director on a fee-for-services basis, such payments should not be approved and that payments made on that basis would not be accepted as proper use of grant funds. They also said that time and attendance records were required for all full-time as well as part-time employees.

We believe that permissive grant administration by HEW was a contributing factor in the receipt by the corporate officers of grant funds which exceeded amounts approved for them and the lack of adequate documentation to support the amounts paid, supposedly on a fee-for-services basis.

HEW approved grants with (1) overlapping budget periods, (2) more than one position title and salary rate applicable to the same individual for the same period of time, and (3) the percentage of time to be devoted to project activities not consistent under different grants for the same individuals for the same period of time. Such situations would tend to confuse a determination of the amounts to be paid to the corporate officers and make the monitoring of the HMOSC grants difficult. Also, HEW officials had an indication that payments were being claimed on a fee-for-services basis, but neither prohibited nor included a specific requirement for adequate documentation of such payments in the grant agreements.

EFFORTS MADE TO OBSCURE PAYMENTS
TO CORPORATE OFFICERS FOR PERSONAL
SERVICES

The first bank loan of \$50,000 was made on July 6, 1972, and on that date the three corporate officers were paid a total of \$40,000 of the loan proceeds, which had been deposited in a separate bank account. Each of the checks comprising this \$40,000 withdrawal showed the purpose of the payment

to be "loan." The bank loan was subsequently paid with three drafts on the grant account, each of which showed the purpose of the draft to be loan repayment. Thus there was no record in the grant account of the \$40,000 paid to the corporate officers. The Executive Director told us that these payments were in fact for personal services and that they were handled in this way to avoid payment of income taxes. None of the "loans" were repaid to HMOSC as of April 23, 1974.

On July 20, 1972, an additional \$5,000 check was written to the Medical Director from the loan proceeds and shown as an advance. There is no indication that this "advance" was ever returned.

In December 1972, a check for \$5,000 was drawn on the grant account and used to set up a bank savings account in the name of HMOSC. This savings account was then used to secure a bank loan of \$5,000. The proceeds of this loan were then deposited in the bank account with the remaining proceeds of the previous \$50,000 loan, and disbursed, again as "loans," to the Medical Director and the Executive Director. On March 22, 1973, the savings account was used to liquidate the \$5,000 loan. The net effect of this transaction was to pay grant funds to corporate officers without having the payments show up as such in grant records. The Executive Director told us that these payments, too, were for personal services and that the payments were handled in this way to avoid payment of income taxes.

Inasmuch as grant funds were used to repay the bank loans from which these payments were made to the corporate officers we have included these amounts as payments for personal services in computing the excess amounts paid to them (see pp. 15 and 42).

There were no Federal tax withholdings from any amounts paid to the corporate officers and HMOSC did not report the payments to the Internal Revenue Service

PERSONAL USE OF GRANT
FUNDS BY CORPORATE OFFICERS

On July 6, 1972, in conjunction with arrangements for the \$50,000 loan made on that date, the Counsel wrote to the bank, saying, "[We] * * * will make arrangements with you to draft

against these accounts for our personal loans." The accounts referred to are the account in which grant funds were deposited and the account in which the proceeds of the \$50,000 loan were deposited.

On six occasions in August, September, and October 1972, the bank debited the grant account a total of \$5,361.52 and transferred these funds to the Counsel's personal account. When he resigned from HMOSC in May 1973, the Counsel deposited \$5,361.52 in the grant account and these bank debits were reversed.

The Medical Director and the Executive Director discussed this matter with HEW officials to some extent on May 3, 1973, but indications are that it was then termed a bookkeeping error on the part of the bank. On May 31, 1973, the Medical Director wrote to HEW stating that he had learned in October 1972 that the HMOSC account was being drafted for the personal account of the Counsel, that the Counsel's authority to sign checks on the HMOSC bank account had been rescinded in October 1972, that the amount transferred from the HMOSC account to the Counsel's personal account had been redeposited to the HMOSC account, that the Counsel's resignation had been accepted, and that he had contacted a public accounting firm to make an audit. HEW responded on June 8, 1973, that the change in corporate officers was acceptable and expressed interest in seeing the results of the audit, but took no further action.

On July 7, 1972, the bank transferred \$1,138.10 from the bank account in which the proceeds of the \$50,000 loan had been deposited to one of the Counsel's client trustee accounts. Inasmuch as the \$50,000 loan was subsequently paid with grant funds, this was in effect a transfer of \$1,138.10 in grant funds. The Counsel told us that HMOSC owed him this amount and more, for services rendered, and that he didn't think he should repay it.

In addition, the Counsel was paid \$1,080 for office equipment which is not now in the possession of HMOSC and is not otherwise accounted for, and was reimbursed \$600 for office equipment which cost him \$500.

We included the \$1,138.10, the \$1,080 and the \$100 as amounts paid to the Counsel for personal services in our computation of excess payments to him (see pp. 15 and 42.)

On August 23, 1972, the bank debited the grant account for \$6,500 and credited the amount to a passbook savings account. The savings account was then used to secure a personal loan of \$6,500 to the Medical Director. On May 17, 1973--the same date on which the Counsel repaid the charges against the grant account for his personal use--a check for \$6,500 was drawn on the grant account in favor of the Medical Director and then redeposited in the grant account to reverse the August 1972 bank debit. The passbook account was then used to liquidate the personal loan. The \$6,500 check drawn in favor of the Medical Director on May 17, 1973--which was a counter check rather than one from the regular grant account checkbook--showed the purpose of the check to be "to adjust services rendered through 8/23/72."

The Medical Director purchased an automobile for \$1,203.50 from the proceeds of the \$50,000 bank loan. He later sold the car to an HMOSC employee and paid--also from the loan proceeds--the latter's insurance premium of \$200.20. The Medical Director told us that the cost of the car and the insurance premium represent payment to him for services rendered.

In addition, the Medical Director was paid \$535.31 from the grant account to reimburse him for expenses which had been paid initially from the proceeds of the \$50,000 bank loan--on the assumption, he said, that the proceeds of the loan were his personal funds. Inasmuch as grant funds were used to repay the bank loan, this payment represented a duplicate payment of those expenses and a payment to which the Medical Director was not entitled.

We included the \$6,500, the \$1,203.50, the \$200.20, and the \$535.31 as amounts paid to the Medical Director for personal services in our computation of excess payments to him (see pp. 15 and 42.)

Transportation costs of members of the corporate officers' families were also paid with grant funds. See page 30.

GRANT FUNDS USED TO PAY
EXPENSES OF A FIRM IN
WHICH CORPORATE OFFICERS
HAD A FINANCIAL INTEREST

The Medical Director and the Executive Director were incorporators and officers of Management Systems, Inc. of South Carolina (MSISC), and until September 1973 the Executive Director was manager of the Charleston office of the firm.

From March to July 1973, HMOSC paid \$1,675 in salary to a person who told us that while she was on the HMOSC payroll 100 percent of her time was spent on MSISC work.

From November 1972 through October 1973, HMOSC paid \$3,978 in salary to another MSISC employee who told us that HMOSC paid her whether or not she performed any work for the project. In a letter to the Medical Director she made the statement that HMOSC paid her because she relieved the Executive Director of some of his duties with MSISC to permit him to devote time to HMOSC. The grant for that period provided for the Executive Director to be employed full-time on the project.

In addition to the direct payments of MSISC expenses, from July 1973 to February 1974, HMOSC sublet office space to MSISC for \$330 less than its cost to HMOSC, and office furniture and equipment which cost HMOSC \$363.72 was sold to MSISC for \$284.32

The allowability of the above payments is discussed on page 48

NO RECORD OF BASIS FOR DOING BUSINESS
WITH FIRMS IN WHICH CORPORATE
OFFICERS HAD INTERESTS

MSISC is a franchisee of Management Systems, Inc. of America (MSIA). The incorporators of MSISC were the Medical Director, the Executive Director, and the president of MSIA. HMOSC paid \$20,750 to the president of MSIA for a computer software package to be used when HMOSC achieved operational status.

The Medical Director told us that HMOSC had obtained bids from two other computer companies but they were substantially higher than MSIA's bid, and he furnished us the proposal received from one of the other companies. He could not locate the proposal of the second company. More importantly, HMOSC has no record--such as an invitation to bid or a request for proposal and no procurement file--to show that the other companies were asked to bid on the same package that MSIA bid on or that they received the same information that MSIA may have received.

HEW regional office officials told us that the president of MSIA came into the regional office to discuss with them the merits of his proposed software package for HMOSC and that they had agreed to HMOSC's purchase of the package. They told us, however, that they did not know that the two HMOSC officers had joined the president of MSIA in incorporating MSISC and that if they had known of this relationship they would have examined the proposed transaction more closely.

The HMOSC Counsel was an incorporator of All Services, Inc., a firm which occupied space in his law offices--as did HMOSC and MSISC until July 1973. HMOSC paid about \$350 to All Services, Inc., for a paging service, again without a showing that such payment was in the best interest of the project.

HMOSC also paid about \$3,000 to another incorporator of All Services, Inc., for service as a consultant in drawing up a communications plan.

Arrangements such as those above provide no assurance that amounts paid for goods and services are reasonable or in the best interest of the project.

CHAPTER 5

OTHER PAYMENTS

PERSONAL SERVICES

Amounts budgeted and spent during the period November 1, 1971 through December 31, 1973, for personal services of persons other than the three corporate officers were \$75,046 and \$62,917, respectively

Supplementation of regular salaries

The HEW policy statement does not permit bonus payments or supplementation of base salary. However, three HMOSC employees have received such payments in addition to their base salary.

In August 1972, HMOSC conducted a marketing survey of employers in the Charleston area, paying a number of college students \$10 for each survey form returned. An HMOSC employee (the Executive Director's brother), who then was being paid a salary of \$75 a week, was not paid his regular salary for one week but was paid instead \$830 for supervising the survey and \$200 for returning 20 survey forms.

The grants provided a total of \$14,976 for the position of Provider Relations Director for calendar year 1973. The person who occupied that position was employed by HMOSC on March 1, 1973, at a salary rate of \$1,303.50 a month--a total of \$15,642 a year or \$666 more than the budgeted amount. This employee was paid his regular salary of \$1,303.50 a month through October 1973, but, apparently because of the shortage of funds in late 1973, was not paid his regular salary in November and December. However, when the \$30,000 bank loan was obtained on December 21, 1973, he was paid a "year end adjustment" of \$3,788.80, resulting in supplementation of his base salary by \$1,181.80.

Also in addition to his regular salary, the employee was paid a \$3,600 bonus for negotiating a nonprofit, tax exempt status for HMOSC.

For five pay periods beginning in January 1974, an HMOSC secretary for whom the approved budget provided Federal funds at a rate of \$318.75 a pay period was paid salary at a rate of \$450 a pay period. In addition to her salary each pay period, she was paid \$197 from which no withholdings were made. An HMOSC employee told us that the additional salary payments were to compensate her for added responsibility as a public relations representative of HMOSC. In this connection, we were told that she had to be available 24 hours a day and the extra \$197 was for auto, entertainment, and clothing expenses incident to her added responsibilities. After we discussed these payments with HEW officials on March 12, 1974, the secretary's salary was reduced to \$354.16 each pay period (an amount based upon the annual budgeted rate for her which includes an amount to be paid from non-Federal funds and which is still \$35.41 more than the amount of Federal funds provided for her) and the \$197 payments were discontinued.

The allowability of these payments is discussed on pp. 42 and 45.

Earnings not reported to
Internal Revenue Service

No deductions were made for Federal or State income taxes or FICA, and Wage and Tax Statements (forms W-2) were not submitted to the Internal Revenue Service for an HMOSC employee who was paid \$9,469.62 in 1972 (\$2,119.50) and 1973 (\$7,350.12).

During 1973 the HMOSC employee who received the \$3,600 bonus and the \$3,788.80 year-end-adjustment discussed on page 26 was paid a regular salary totaling \$10,428. Taxes were withheld only from the regular salary payments, and the remaining payments totaling \$7,389 were not reported to the Internal Revenue Service.

During 1973, another HMOSC employee, paid a regular salary which totaled \$9,500, received a salary advance of \$1,000 which was not repaid, and a year-end adjustment of \$480. Taxes were withheld only from the regular salary payments, and the remaining payments totaling \$1,480 were not reported to the Internal Revenue Service.

TRAVEL

HEW's policy statement applicable to the grants to HMOSC provides that if a grantee has an established travel policy, that policy will govern expenditure of grant funds, and that in the absence of such a policy the Standardized Government Travel Regulations (SGTR's) will be applied. HMOSC has no written travel policies and procedures. Grantee officials stated that their practices constituted their established policy and thus governed the expenditure of grant funds. HEW regional officials told us that in order for a grantee's policy to be an established policy as contemplated in the policy statement it must be in writing, approved by the grantee's board of directors, and approved by HEW. In our opinion, HMOSC does not have an established travel policy and the SGTR's govern its expenditure of grant funds for travel.

Travel budget exceeded
without HEW approval

Amounts budgeted and spent for travel during the period November 1, 1971 through December 31, 1973, were as follows.

	<u>Budgeted</u>	<u>Spent</u>
Travel within project area	\$ 5,488	\$ 7,248 27
Travel out of project area	<u>5,050</u>	<u>13,535 49</u>
	<u>\$10,538</u>	<u>\$20,783.76</u>

HEW's policy statement applicable to the grants to HMOSC provides that grantees may not use grant funds to pay travel expenses in excess of the amount budgeted for travel without advance approval of HEW. HMOSC did not receive advance HEW approval to spend more than the budgeted amount.

The allowability of the excess expenditures is discussed on page 45.

Travel practices and expenses not in
compliance with SGTR's

The following HMOSC travel practices and expenses are contrary to the SGTR's. In general discussions of these

matters, the Executive Director took the position that HMOSC was a private corporation whose funds were private funds and, therefore, not subject to the Government's regulation

Travel vouchers not submitted

The SGTR's require that claims for reimbursement of travel expenses be supported by vouchers which itemize the expenses incurred. HMOSC officers and employees frequently did not file expense vouchers to support amounts paid to them. Complete supporting documentation was not available for 139 of 202 travel expenditures. The lack of such documentation precludes any definitive determination of the extent to which grant funds have been misused.

Excessive advances not accounted for

The SGTR's authorize travel advances where warranted, considering the character and probable duration of the travel and the cost of transportation to be paid for by the employee. They also provide that amounts advanced will be deducted from total expenses allowed or otherwise recovered.

HMOSC routinely made travel advances for more than reasonably expected travel costs, and there was no accounting for the advance. Some examples are,

- the Executive Director received a \$500 advance for which he made no accounting. He told us that the advance was for a 7-day trip to Morehead City, North Carolina. On that basis, the maximum subsistence allowance payable under the SGTR's would have been \$175, and round trip mileage would have been about \$62.
- the Medical Director received a \$500 advance for a time when he acknowledged that he was on vacation. He made no accounting for the advance
- the Medical Director received a \$200 advance to attend a 2-day seminar in Columbia. He made no accounting for the advance. The maximum allowable subsistence payment would have been \$50 and round trip mileage would have been about \$30.

--For a 1-day trip to Washington, the Executive Director received an advance of \$250 for which he made no accounting. The maximum subsistence allowable payable under the SGTR's would have been \$18 75. HMOSC paid the airline for his transportation.

HMOSC officials told us that any travel advances received in excess of allowable travel expenses were considered to represent additional income to them.

Transportation of corporate officers' families

The SGTR's provide that travel expenses to be reimbursed will be limited to those which are essential to the transaction of official business. The HEW policy statement limits use of grant funds to expenses which are required in carrying out the purposes of the grant.

Available documentation shows four occasions on which grant funds were used to pay transportation costs of members of corporate officers' families, as follows:

February 3, 1972	
Airfares for the Executive Director's wife and son to Washington, D C , and return	\$108 20
August 30, 1972	
Airfare for the Medical Director's son to Atlanta and return	49.50
September 14, 1973	
Airfare for the Executive Director's wife and two children to Atlanta	68 91
November 15, 1973	
Airfare for the Medical Director's son from Orlando, Florida, to Charleston, and return	<u>170 81</u>
	<u>\$397 42</u>

The Executive Director told us that he considered the cost of his family's trip to Washington as a payment for personal services rather than as payment for expenses. The purpose of the check is shown as "expenses," but the payment was classified in the cash disbursements journal as "personal services." We have included this amount as payment for personal services in the discussions in Chapter 4 and on page 42.

In connection with the transportation of the Executive Director's wife and children to Atlanta, he told us that he had driven to Atlanta to meet with MSIA representatives on HMOSC business but did not charge mileage for the trip. He said that the cost of his family's airfare was taken in lieu of his being paid mileage. He also told us that he had received a travel advance to cover the cost of meals and lodging for one night. However, HMOSC's records do not show payment of either a travel advance or travel expenses to the Executive Director for a trip to Atlanta in September 1973.

The Medical Director told us that he had reimbursed HMOSC for the cost of his son's round trip between Orlando and Charleston. However, we found no record of this amount having been received by HMOSC and we were told by an HMOSC employee that it had not been repaid.

Purchase of toys

Also in the category of payment of expenses not related to purposes of the grant was purchase by an HMOSC employee of \$11.97 worth of toys for his children, using an HMOSC credit card. The toys were bought at the airport and the expenditure was recorded as a travel expense.

Routine use of first class air transportation

Both the SGTR's and the HEW policy statement provide that less than first-class air transportation will be used when available. In 37 out of 40 trips for which documentation was available, HMOSC officers and employees flew first class. The Medical Director told us that corporate policy was to use first class travel accommodations.

Payment of travel allowance without regard to extent of travel

Contrary to the SGTR requirements for submission of itemized travel vouchers and for restricting payment to expenses necessary to the transaction of official business, from March to November 1973, an HMOSC employee was paid a weekly allowance for local travel without regard to the extent of his travel--or to whether he traveled. The total amount paid was \$750.

Duplicate payments

In July, August, and September 1972, an HMOSC employee was paid a total of \$731.49 for local travel. There were no supporting documents for \$270.36 of this amount. The remainder (\$461.13) was supported by expense vouchers and other records which showed that he was paid mileage for use of his automobile at a rate of 10 cents a mile plus charges for gasoline and oil. Mileage rates payable under the SGTR's are intended to reimburse employees for all the costs of operating an automobile, and supplementary payments--as for gas and oil--are not allowable. The maximum mileage rate permitted under the SGTR's is 12 cents. Considering the maximum amount payable as being 12 cents a mile for the reported number of miles, the employee was overpaid \$128.85.

On three occasions for which documentation is available, employees who had received travel advances to cover the costs of lodging and meals used HMOSC credit cards to charge such costs. HMOSC subsequently paid the credit card accounts, but the duplicate payments were not recovered from the employees. Such credit card charges totaled \$36.12 for one employee and \$48.88 for another.

MISCELLANEOUS

Cost of meals at local restaurants

The HEW policy statement permits use of grant funds for purchase of meals only if the purpose of the grant is to provide meals. Included in the expenses recorded as in-area travel were amounts totaling \$530.58 which were shown by available documentation to be for meals at local restaurants for HMOSC officers, employees, and their guests. The allowability of these expenditures is discussed on page 50.

Purchase and sale of camera

On August 7, 1973, HMOSC purchased for \$775.59 a new camera and electronic flash unit. On three occasions between November 14 and December 3, 1973, HMOSC bought classified ads in the newspapers attempting to sell the camera and flash equipment. An HMOSC employee told us that the organization ran out of money and was attempting to sell the camera to raise funds for salaries, but was unsuccessful in those attempts. He told us on February 28, 1974, that the camera had been given to an HMOSC employee so that he could try to sell it, but that he did not know whether the employee's efforts had been successful.

The employee told us that he had sold the camera about January 3, 1974, for \$371.50 and had kept the proceeds of the sale as payment for services. There was no record in HMOSC that the camera had been sold or that the proceeds of the sale represented payment to the employee for services rendered. Beginning with the last pay period in June 1973, the regular bimonthly salary payment to the employee was \$325. He received one such payment in November and on December 21, 1973, when the \$30,000 loan was obtained, he was paid a \$650 "year-end adjustment," resulting in his having missed one regular salary payment.

The allowability of the purchase of the camera with grant

funds and the employee's retention of the proceeds from sale of the camera are discussed on page 48

Insurance

The HEW policy statement specifically prohibits use of grant funds to pay for insurance on equipment HMO SC paid \$61 for fire and theft insurance on office furniture and equipment

HMO SC paid \$1,820 52 in premiums on "key man" life insurance policies on the Counsel and the Executive Director Although HMO SC was the beneficiary of this insurance, the policies did make available to the insureds substantial loan values and provide for a life income to the insureds at age 65 HMO SC's files contained a letter from the insurance agent stating that HMO SC's Counsel had discussed with him "the prospects of changing both the ownership and beneficiary in order that the individuals and/or their estates would more directly benefit from this protection and investment" and that he (the agent) had some suggestions as to how this might be accomplished We found nothing in HMO SC's records to indicate change of the policies The allowability of the cost of this insurance is discussed on page 46

Interest and other
loan expense

Grant funds in the amount of \$1,118 16 were used to pay interest and other expenses on bank loans The allowability of these payments is discussed on page 47.

CHAPTER 6

PROGRAM STATUS

The primary objective of all the Federal grants to HMOSC has been to bring into existence an operational HMO in the Charleston area. The expected date for achieving that goal has been set and changed a number of times. When the last grant was awarded, it was expected that HMOSC would achieve operational status by July 1, 1974. In our opinion, the prospects are remote that HMOSC can achieve operational status on any scale by July 1, or that, as presently constituted, it can ever operate on the scale envisioned in the grants.

The primary obstacle to achieving operational status on any scale by July 1 is confusion concerning the legal status of HMO's under existing State laws, and uncertainty as to whether the Health Maintenance Organization Act of 1973 (Public Law 93-222; 87 Stat 914) will pre-empt the restrictive provisions of the State law. The unresolved question essentially is whether an HMO is an insurance company or a provider of health services. An operational HMO may need to buy risk insurance--i.e., insurance to cover larger-than-expected losses-- before it can interest either providers or consumers. In South Carolina, only insurance companies are permitted to purchase risk insurance. And if an HMO were to be classified as an insurance company so as to be able to purchase risk insurance, it would have to be regulated as an insurance company and meet fund reserve requirements placed upon insurance companies.

Both HMOSC and HEW have been aware of the legal obstacle to operational HMO's in South Carolina since inception of the project, but have proceeded on the assumption that the matter would be favorably resolved. Clarifying legislation has been introduced in the last two sessions of the State legislature but to date nothing has been passed.

The Medical Director told us that in an effort to begin operations under the existing law he is negotiating with two insurance companies to get them to offer the HMOSC benefits package as an option in their health care insurance programs. In that way, HMOSC would be only a provider of physician services, with the insurance company collecting premiums from enrollees and being at risk for all aspects of the benefits package except physician services. HMOSC would be

paid, by the insurance company, a predetermined amount for each enrollee and would be at risk for the cost of physician services. However, largely for the reasons discussed below, this arrangement would be carried out only by the Medical Director and possibly one other doctor to be brought in from outside the Charleston area, and would be conducted only from the Medical Director's two offices located in Mount Pleasant and Summerville. There had been no agreement with an insurance company at the conclusion of our work in Charleston on April 23, 1974. If such an agreement can be reached, we consider it highly unlikely that HMOSC could be operational, even on this severely limited basis, by July 1, 1974.

As outlined in its application for Federal grants, HMOSC has determined that there is a market in the Charleston area to support a properly constituted HMO health care delivery system, and, largely through use of consultants, has developed a benefits package, a marketing plan, and a communications plan, and has acquired a computer software package to handle accounting for premium collections and provider charges and to develop patient and provider profiles. It has not found a source of start-up capital, it has only two agreements with providers (ambulance services), and it has no agreements with employers to participate in its plan or to offer it as an option to their employees.

The Medical Director believes that the key to HMOSC's achieving operational status is either passage of favorable State legislation or Federal pre-emption of the restrictive State law. He believes that then he would be able to obtain risk insurance and start-up capital, and that employers in the area then would participate in the program. There has been one important change in his approach, however, which would seem to preclude operation on the scale anticipated in the grants.

An essential feature of the program outlined in the grants was the participation of private physicians and dentists, with enrollees being free to select their own doctors (referred to as a decentralized HMO). For whatever reasons--and our review was not concerned with determining and evaluating the reasons--HMOSC has engendered considerable opposition in several segments of the community, including the Charleston County Medical Society. Because of this opposition, the Medical Director has, at least for the present,

abandoned the idea of widespread participation of local physicians and has attempted to recruit physicians from outside the Charleston area to staff a more centralized, or clinical, HMO. In this effort he has contacted medical schools and State medical societies across the country but so far has had no success.

ERNEST F HOLLINGS
SOUTH CAROLINA

OFFICES
SENATE OFFICE BUILDING
202 225 6121
FEDERAL BUILDING COLUMBIA S C
803 765 5731
FEDERAL BUILDING SPARTANBURG S C
803 585 8271
141 EAST BAY CHARLLSTON S C
803-723 5211

United States Senate

WASHINGTON D C 20510

December 14, 1973

COMMITTEES:
APPROPRIATIONS
SUBCOMMITTEES
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BENEFITS

Congressional Liaison
General Accounting Office
441 G Street
Washington, D C 20548

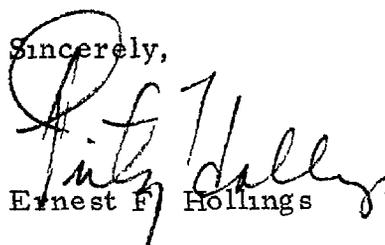
Dear Sirs

I have received inquiries from constituents of mine concerning the HMOSC program. It would be helpful if you would investigate this matter and send me a report that would include the Quarterly Reports, Expense Account Reports, audit figures, salaries and the kinds of contractual commitments this organization is involved in. Any other pertinent information concerning the operation of the HMOSC would be appreciated.

I shall look forward to hearing from you

With kind regards,

Sincerely,


Ernest F. Hollings

EFH/mbb

Enclosures

P S Please return the enclosures for my files

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ALLOWABILITY OF CERTAIN EXPENDITURES

A grant which is made subject to certain conditions and restrictions placed upon the grantee obligates the grantee to use the grant funds solely for the purposes set forth in the grant. United States v. San Francisco, 310 U S 16 (1940), 42 Comp. Gen. 289, 294 (1962), Section 16 8(a) The United States retains an interest in the grant funds which enables it, should the granting agency determine that these funds are not being used for the purposes of the grant, to require the grantee to return all such funds to the Federal Government. See 40 Comp Gen 81 (1960), see also United States v. Michigan, 190 U S 379 (1903).

In the course of our review we identified certain expenditures that either are unallowable under the terms of the grants, or are of highly questionable allowability. These are discussed elsewhere in this report, but are summarized here for clarity.

HEW's Policy Statement for Administration of Grants Awarded under Section 314(e) of the Public Health Service Act (policy statement), dated July 1, 1968, is applicable to all HEW grants awarded to HMOSC Section 6(A) of the policy statement provides

"Allowable costs of a project are those specified in this Policy Statement and in Bureau of the Budget Circular A-21 or in other appropriate cost principle policies current at the time of award except as otherwise specified in the notice of grant award "

Principles applicable to these grants included those contained in HEW's Cost Principles and Procedures for Establishing Indirect Cost Rates for Grants and Contracts with the Department of Health, Education, and Welfare, dated August 1970, and those contained in exhibit X1-76-1 of the HEW Grants Administration Manual (Manual), in addition to those contained in the Policy Statement itself, Exhibit X1-76-1 was published, effective September 19, 1973, as Appendix F to 45 C.F.R. pt. 74

The allowability of certain expenditures under the terms of the HEW grants is discussed below. Because of the number of categories for which the allowability of

expenditures is being questioned and the duplication of amounts included in some of the categories, we have not attempted to precisely establish the total amount of questionable payments. However, the amount for which the allowability is questionable under the terms of the HEW grants approximates \$100,000.

ASSIGNMENT OF GRANT FUNDS

On July 6, 1972, the three corporate officers took out a \$50,000 bank loan (\$49,980 net proceeds) in the name of HMO SC. They pledged as collateral an anticipated HEW grant for \$112,440, the first payment of which was received by the grantee on July 31, 1972, in the amount of \$59,910. As this and subsequent grant payments were received, the bank applied them in part against the outstanding balance of the loan. The loan was entirely repaid by December 7, 1972.

Neither the grant document, the Policy Statement, nor the Manual prohibits assignment of grant funds. Under 31 U.S.C. 203, the assignment of monies due or to become due from the United States under any contract providing for payments of \$1,000 or more, is permitted when assigned to a bank, trust company, or other financing institution so long as the contract does not by its terms forbid assignments and written notice of the assignment transaction together with a copy of the instrument of assignment is given to the contracting agency.

A number of decisions have held that Federal grants authorized by Congress create binding contracts. United States v. Sumter County School District No. 2, 232 F. Supp. 945, 950 (E.D. S.C. 1964), United States v. County School Board, Prince George County, Va., 221 F. Supp. 93, 99 (E.D. Va. 1963), Burke v. Southern Pacific Railroad Co., 234 U.S. 669, 680 (1914) (dicta), 42 Comp. Gen. 289,294 (1962), B-167790, January 15, 1973.

This reasoning has been applied to assignment of grant funds. Thus, in a decision of the Comptroller General, 50 Comp. Gen. 470 (1970), the recipient of construction grants applied to a bank for interim loans and proposed to assign to the bank the right to receive the proceeds of the grants when disbursed, in order to pay off these loans. The Comptroller General, not finding in the record any indication that an assignment of the proceeds of the grants was forbidden under the terms of the grants, held that a Federal grant subject to

APPENDIX II

conditions that must be met by the grantee creates a valid contract between the United States and the grantee, and is thus assignable under 31 U S.C 203. Thus, the Comptroller General did not object to the assignment to the bank of the grant funds

There is evidence that HMOSC's Counsel discussed this loan transaction with HEW, and that HEW at least acquiesced in the loan. Such informal notification, while it may have served to put HEW on notice, does not appear to satisfy the requirements of 31 U S C 203, which requires that a written notice of the assignment be filed with HEW by the assignee together with a copy of the instrument of assignment

PERSONAL SERVICES

Section 6(B)(2) of the policy statement provides that bonus payments are not allowable. Section 6(B)(38) provides that no supplementation of base salary is permitted

Section 6(B)(38) of the policy statement also provides for payment of salaries and wages "for time or effort spent on a grant-supported project." Payments to corporate offices for personal services were on an hourly rate but HMOSC failed to keep adequate records of hours spent on HMOSC-related work (see p 18). Although records were prepared in February 1974, our review found them inconsistent with other records, and we consider them not adequate support for the payments made (see p. 18). Although time and effort reports were not required to be submitted by HMOSC (see HMO Supplement to policy statement, dated Sept 17, 1971), the grantee nevertheless must be able to account for grant funds in accordance with accounting practices based on generally accepted principles.

Chapters 4 and 5 of this report refer to situations in which officers or employees of HMOSC received money or goods which represented personal gain to them and which must be considered as income for personal services. To the extent that these amounts resulted in supplementation of base salary they are not allowable.

Where the corporate officers are concerned, the manner in which they were paid (as described in chapter 4) is not conducive to a determination of what constituted their base salaries.

The cost principles define compensation for personal services as, "all remuneration paid currently or accrued in whatever form and whether paid immediately or deferred for services rendered xxx during the period of grant/contract performance. It includes, but is not limited to, salary, wages, directors' and executive committee members' fees, bonuses, incentive awards, employee insurance, fringe benefits, and contributions to pension, annuity, and management employee incentive compensation plans." The cost principles also provide that compensation for personal services is allowable to the extent that "it is paid in accordance with policy, programs, and procedures that effectively relate individual compensation to the individual's contribution to the performance of grant or contract work xxx and effectively relate compensation paid within the organization to that paid for similar services outside the organization "

We believe it reasonable to assume that amounts included in approved budgets for officers and employees represent agreement between HMOSC and HEW as to the base salary for the affected individual, in conformity with the cost principles, and that any payments in excess of such amounts are not allowable under sections 6(B)(2) and 6(B)(38) of the policy statement. To the extent that existing words indicate that payments for personal services could not have been reasonably earned in the applicable time period, HEW may wish to consider whether additional amounts are unallowable.

Special consideration is due a portion of the payments to HMOSC's Counsel. He was an incorporator, director, and fiscal officer of HMOSC. During the time of his association with HMOSC in these capacities, he also maintained a private law practice. The grants included \$23,800 in salary for an Assistant Director, and an HMOSC employee told us that these funds were budgeted for the Counsel. However, he was not paid any salary for that office but was paid as a legal consultant at the rate of \$50 an hour plus expenses for travel, entertainment, etc.

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Generally, under section 6(B)(6) of the policy statement, consultant fees charged to the grant account are allowable provided they are not paid to a full-time Federal employee. Consultant fees may be paid to an employee of the grantee organization only under unusual circumstances and with the prior approval of the Public Health Service.

The grants contained funds budgeted for legal consultant fees. However, an HEW official told us that HEW had not approved consultant payments to the Counsel. Nor is there evidence of any "unusual circumstances" so as to justify employing him instead of an attorney having no other connection with HMOSC. Although the Counsel did not receive a salary for his work as Assistant Project Director such as would indicate an employee relationship to the corporation, the fact that he was shown in the grants as fiscal officer would probably make HEW view him as an employee for purposes of that section.

Section 6(B)(6) could therefore possibly be applicable to the Counsel so as to disallow all expenditures made to pay him for legal fees as a consultant to HMOSC. However, since he could have received a salary for personal services, we believe that only that portion of his legal fees and other amounts received by him that were in excess of the amount budgeted for him should be disallowed.

PUBLIC RELATIONS EXPENSES

From January 1 through March 15, 1974, an HMOSC secretary received, in addition to her salary, a total of \$985 for automobile, entertainment, and clothing expenses for public relations work (see p 27) The approved grant budget did not provide for public relations work

These payments would appear to be unallowable under section G(12) of Appendix F to 45 C.F.R. pt 74, applicable to the 1974 grant, which states that "costs of amusements, diversion, social activities, ceremonials, and incidental costs relating thereto" are not allowable.

TRAVEL EXPENSES

Through December 31, 1973, HMOSC's expenditures for travel exceeded by \$10,246 the amount provided in approved budgets for travel (see p 28) Sections 6(B)(43) and 7(B)(9) of the policy statement require prior approval of the Public Health Service for expenditure of grant funds for travel in excess of the amount provided for travel in approved budgets. Such approval was not obtained, hence expenditures in excess of the budgeted amount are unallowable.

Section 6(B)(43) of the policy statement provides that "The policies of the grantee will govern travel by project staff paid from grant funds, except that less than first class air travel must be used when available U.S. Standard Government Travel Regulations must be followed if the grantee has no established policy " HMOSC has no written travel policies Grantee officials stated that their practices constitute their established policy. This position seems contrary to the concept of an established policy in that prevailing practices are subject to continuous change. Furthermore, an HEW regional office official told us that to qualify as an established policy as contemplated in the policy statement a grantee's policy must be in writing, approved by the grantee's board of directors, and approved by HEW. It seems apparent, therefore, that HMOSC does not have an established travel policy as contemplated in section 6(B)(43) of the policy statement and that any expenditures for travel contrary to the Standardized Government Travel Regulations are not allowable Costs of first class air travel in excess of the cost of tourist class travel are

not allowable absent a showing that less-than-first-class accommodations were not available

INSURANCE PREMIUMS

Automobile insurance

As discussed on page 23, the Medical Director purchased an automobile from the proceeds of a \$50,000 bank loan which was repaid with grant funds. He later sold the car to an HMOSC employee and paid--also from the loan proceeds--the latter's insurance premium of \$200.20. The Medical Director told us that the cost of the car and the insurance premium represent payment to him for services rendered.

Under section 6(A) of the policy statement, the grantee may charge Federal grant funds only for those expenditures "required to carry out the approved project." In that the Medical Director regarded the automobile as his personal property, grant funds properly should not have been used to pay the insurance premiums on that car. The entire \$200.20 must be viewed as a nonallowable expenditure.

Fire and theft insurance

During August and September 1973, HMOSC issued two checks in the total amount of \$61 for fire and theft insurance on office equipment and furniture owned by HMOSC.

Section 6(B)(25) of the policy statement provides that insurance premiums paid on equipment are not allowable.

Key-Man insurance

On July 14, 1972, \$840.97 was paid for key-man insurance on two of the corporate officers. Additional disbursements were made for key-man insurance for one of the officers as follows:

April 10, 1973	\$176.12
June 26, 1973	267.81
February 19, 1974	267.81
March 21, 1974	267.81

The policy statement expressly permits the grant account to be charged for premiums for hazard, malpractice, and liability insurance for personnel directly connected with the project but does not address the issue of key-man insurance

However, section 6(B) of the policy statement provides that determination of the allowability of any item not specifically covered therein will be "based upon the treatment of, or standards provided for, similar or related items in accordance with the policies and procedures of the grantee." In this connection, section 6(B)(7) of the policy statement prohibits the maintenance of contingency funds to cover unforeseen events, an item to which key-man insurance may be analogous. Section J(8) of OMB Circular A-21 includes as contingency items any "provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening." Key-man insurance appears to fall within this definition.

Some further guidance may be drawn from section G(17)(c) of the Manual (carried forward in App. F, 45 C.F.R. pt. 74) which allows the cost for insuring the lives of officers and employees of the organization only to the extent that the insurance represents additional compensation to those officers and employees. Key-man insurance, however, has as its basis that lives of key corporate officials are insured with the corporation as the beneficiary. In such an instance, this insurance could not represent additional compensation to those officers and employees, and should thus be viewed as not allowable.

INTEREST AND OTHER
LOAN EXPENSE

Interest charges, stamps, and documentary fees of \$1,118.16 paid on the \$50,000, \$20,000, \$5,000, and \$30,000 loans taken out in the name of HMOSC (see p. 34) are not allowable under section G(18) of the Manual (carried forward in App. F, 45 C.F.R. pt. 74) which provides that "costs incurred for interest on borrowed capital or temporary rise of endowment funds, however represented, are unallowable."

PURCHASE AND SALE
OF CAMERA

On August 7, 1973, HMOSC purchased a camera and flash attachment at a cost of \$775.59 (see p 33) This was not a budgeted item and prior HEW approval to purchase this item was neither required nor obtained On January 3, 1974, approximately five months after the camera was purchased, an HMOSC employee sold the camera and flash for \$371 50 or about 48 percent of the purchase price The employee kept the money from the sale of the camera, as payment, he said, for personal services.

HMOSC officials said that the camera was obtained for use in the marketing program HMOSC had received grant funds for use in developing a marketing plan, but not to implement a marketing program It is not clear how the camera would have been used in developing a marketing plan, leaving the purchase of the camera highly questionable under the provisions of section 6(A) of the policy statement which limits use of grant funds to expenditures which are required to carry out the approved project.

Clearly, the method employed in the disposal of the camera did not comply with applicable procedures. Under section 8(B) of the policy statement, when equipment is transferred or disposed of "during its useful life to a use outside the scope of the Public Health Service objectives," an amount equal to the value of that item at the time of disposal must be deposited in the grant account. This was not done

PAYMENT OF EXPENSES OF
MANAGEMENT SYSTEMS, INC
OF SOUTH CAROLINA

MSISC is a franchise operation providing a computerized billing service for physicians and dentists. Two of the HMOSC officers were incorporators and directors of MSISC In addition, one of the officers was also the manager of MSISC at the same time that he was serving as Executive Director of HMOSC

Rented space

From July 1973 to February 1974, HMOSC leased excess space and sub-let it to MSISC. During the period that

MSISC occupied the HMOSC office space, HMOSC paid \$330 more for the space rented to MSISC than it charged MSISC (see p. 24).

The grantee is vested with the responsibility under the Preface to the policy statement of exercising "the same probity and prudence" in the expenditure of grant funds as it would exercise for its own funds. Certainly, a grantee should not sub-lease space to another party for less than what the space costs the grantee. The deficit thus created by HMOSC amounts to a subsidization of MSISC with grant funds. MSISC performed no work for HMOSC under the terms of the grant. Under section 6(A) of the policy statement the grantee must assure that grant funds are utilized only for purposes for which they were awarded, and expenditures falling without the scope of the grant's purposes are unallowable. That is the case here and the \$330 expended on account of MSISC is not allowable.

Sale of furniture and equipment

About June 15, 1973, HMOSC sold to MSISC for \$284.32 office equipment and furniture which cost HMOSC \$363.73, as follows:

<u>Item</u>	<u>Date of purchase</u>	<u>Purchase price</u>	<u>Sales price</u>
File cabinet	11- 7-72	\$51.94	\$40.00
File cabinet	11-11-72	41.55	40.00
Desk	3- 1-73	82.68	77.16
Desk	3-14-73	82.68	77.16
Chair	3-12-73	45.60	25.00
Chair	11-29-72	59.28	25.00

Under section 8(B) of the policy statement when equipment is transferred or disposed of "during its useful life to a use outside the scope of the Public Health Service objectives" an amount equal to the value of that item at the time of disposal must be deposited in the grant account. The sales proceeds of \$284.32 were deposited in the grant account, but--considering the purchase price and the relative newness of the items, and the relationship of the HMOSC officers to MSICS--we think there are reasonable grounds to question whether that amount represented the value of the

APPENDIX II

item sold. To the extent that it did not, a deposit should be made to the grant account from some source other than grant funds.

Salaries for MSISC employees

HMOSC paid the salaries of two MSISC employees--one of whom received \$1,675 in the period March to July 1973 and performed no service for HMOSC, one of whom received \$3,978 in the period November 1972 to October 1973 and was paid by HMOSC whether or not she performed service for HMOSC. To the extent that these salaries were paid for non-HMOSC related functions they are not allowable under section 6(A) of the policy statement which limits use of grant funds to purposes for which they were awarded.

COST OF MEALS AT LOCAL RESTAURANTS

Available records show that \$530.58 in grant funds was spent for meals at local restaurants for HMOSC officers, employees, and their guests. Section 6(B)(29) of the policy statement permits use of grant funds for payment of meals only if the provision of meals is a purpose of the grant. Such is not the case here, and the cost of meals is not an allowable charge to grant funds.

USE OF GRANT FUNDS TO PAY EXPENSES OF PREVIOUS GRANT PERIODS

Through March 31, 1974, HMOSC had used \$34,830 of funds awarded for project costs in calendar year 1974 to pay outstanding notes and accounts payable at December 31, 1973. These notes and accounts payable represented expenses which had been incurred in excess of approved budgets for the period November 1, 1971-December 31, 1973.

Section 8(B) of the policy statement contains the following provision.

prior to the beginning date of a continuation award, the grantee may at his own risk, incur expenditures which exceed PHS authorization but which are considered essential to the conduct of the project. The awarding office will allow

reimbursement of such expenditures from the continuation grant when awarded, provided that the items covered are incorporated in the approved budget of the continuation grant and that, where required for restricted categories, prior approval was obtained. (Emphasis added.)

HMOSC did not include in the approved budget of the 1974 continuation grant any of the amounts expended which exceeded the approved budgets of the 1972 and 1973 continuation grants, and therefore did not meet that condition required for reimbursement by HEW of these additional obligations. Thus, by the terms of section 8(B), HMOSC incurred expenses exceeding the approved budget at its own risk, and use of funds provided for a later grant period are not available to pay those expenses.